No. 9920

In the United States Circuit Court of Appeals for the Ninth Circuit

J. Howard Porter, John C. Porter and Paul D. Porter, Identified Under the Trade Name Porter Property Trustees, Ltd., petitioners

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 22–40) is reported in 42 B. T. A. 681.

JURISDICTION

This petition for review (R. 42–45) involves federal income and excess-profits taxes for the taxable year 1935. On July 11, 1938, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of $3,597.57. (R. 10–20). Within ninety days thereafter and on October 8, 1938, the taxpayer filed a petition with the Board of Tax Appeals for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 4–20). The final order and decision of the Board of Tax Appeals sustaining the deficiency, was entered on March 5, 1941. (R. 41.) The case is brought to this Court by a petition for review filed June 2, 1941 (R. 42–45), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the trust of which the petitioners are trustees was an association, and therefore taxable as a corporation during the taxable year 1935, within the meaning of Section 801 (a) (2) of the Revenue Act of 1934, as determined by the Commissioner and held by the Board, or a pure trust and taxable as such, as claimed by the petitioners.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 36–39.

STATEMENT

The facts, as stipulated in part (R. 46–50), and as developed partially from the evidence adduced at the hearing of the case (R. 50–92), were found by the Board of Tax Appeals, as follows (R. 23–34):

J. Howard Porter, John C. Porter, and Paul D. Porter, are the trustees of the petitioner, Porter Property Trustees, Ltd., an express trust, created by a written instrument dated February 28, 1935. Before February 28, 1935, the entire outstanding capital stock of the James Porter Investment Company, a Delaware corporation, consisting of 2,808 shares, was owned and held by James Porter and Katie E. Porter, husband and wife, and members of their family. (R. 23.) The following shows the interest and relationship of each stockholder (R. 24):

Name	Relationship	Shares held
James Porter	Father	685
Katie E. Porter	Mother	1,858
Paul D. Porter	Son	50
B. F. Shumway	Nominee for father	65
W. N. Dennison	Husband of daughter (Elizabeth)	50
Rebecca P. Wells	Daughter	50
James Howard Porter	Son	50
John C. Porter	Son	0
Elizabeth P. Dennison	Daughter	0
Total		2,808

On February 28, 1935, and for some time before then, the James Porter Investment Company was the owner of certain personal property, and also held in fee simple certain land, mainly agricultural and unimproved, and situate in Kern County and San Luis Obispo County, California, Nobles County, Minnesota, and Grundy County, Iowa. This land was acquired by the James Porter Investment Company at the time of its incorporation in 1930, from James Porter and Katie E. Porter in exchange for its capital stock. Such of its personal property as was not acquired by that company in a like manner, and at the same time, was acquired by the company in the course of its ordinary business activities afterwards but before February 28, 1935. Certain of these lands had been improved before and during the period held by the company, and farming operations were carried on by leaseholders for profit on part of these lands while they were owned and held by the company. (R. 24.)

On February 28, 1935, James Porter, Katie E. Porter, Paul D. Porter, F. B. Shumway, W. M. Dennison, and James Howard Porter, as grantors, and James Howard Porter, Paul D. Porter, and John C. Porter, as trustees (hereinafter sometimes referred to as the trustees) executed and entered into a written "Conveyance and Contract" agreement, incorporated herein by reference, the relevant parts of which are later set out, by which the trust involved herein, known as the Porter Property Trustees, Ltd., was created. By the terms of the trust instrument, the trustees were selected and appointed by the grantors, and were therein designated and described as the board of trustees and were authorized to act under and use the trade name of Porter Property Trustees, Ltd. There were transferred and conveyed to the trustees at the time of creation of the trust 1,723 shares of the capital stock of the James Porter Investment Company which constituted all the shares shown in the table above, except the 685 shares in the name of James Porter and 400 of the 1,858 shares in the name of Katie E. Porter. On the day of their constitution as such, February 28, 1935, the trustees, acting in their collective capacity, acquired from James Porter the 685 shares noted above in consideration for their assumption of his debt in the amount of $52,000. (R. 25.)

The interests of the respective trust beneficiaries are described in the trust instrument as "expectancy fractions." (R. 25.) Article 15 of the trust instrument provides as follows (R. 26):

> Art. 15. Registration & dormant fractions: Expectancy Fractions under this administration shall at first be allotted in the records of the Board under instructions delivered to the Board by James Howard Porter. Should fractions appear dormant thereby, while held dormant they shall not be reckoned with when apportioning in distributions, such being computed solely by or upon the fractions registered as to beneficiaries at time of making each distribution. Dormant fractions, their usefulness being contingent upon possible future conveniences, remain subject to the discretion of the Trustees.

Pursuant to the provisions of "Art. 15" of the trust instrument, under instructions from James Howard Porter, expectancy fractions were allotted in the records of the board of trustees as follows (R. 26):

Name:	*Expectancy fractions*
Paul D. Porter	290/1000
John C. Porter	290/1000
Rebecca P. Wells	65/1000
Elizabeth P. Dennison	65/1000
James Howard Porter	290/1000
Total	1000/1000

Immediately after the trustees had acquired the 2,408 shares of the James Porter Investment Company on February 28, 1935, as set forth above, they exchanged them with that company for all its assets (except one parcel of real estate situate in Grundy County, Iowa, known as the Porter Homestead), subject to its then outstanding liabilities. Shortly thereafter the company was liquidated and dissolved. (R. 26–27.)

Included among the assets of the company thus acquired were certain land sale contracts which provided for future payments by the purchasers, some of them not becoming due and payable until after their acquisition by the trustees. At this time the company was treating with the Standard Oil Company for the lease by the latter of a part of these lands situate in Kern County, California. The negotiators had by then reached an agreement for the execution of a lease which was to be executed by the James Porter Investment Company for the use and benefit of the Porter Property Trustees, Ltd., and then to be assigned to the trustees. This was accordingly done. Under its terms the lessee was obligated to explore, develop, and drill certain wells on the leased land for oil or gas of commercial quality and in commercial quantity. This was done but no oil or gas was found, and the lessee quitclaimed its interest to the trust in the year 1938. Under the terms of this lease agreement certain oil and gas royalty interests were retained by the lessor, in addition to the bonus paid by the lessee for the execution of the lease. (R. 27.)

The trust instrument provided for the following additional matters: (1) The trustees were given the power to sell and to convey and deliver any, all, or such of the trust properties as they might see fit, in their discretion; (2) the trustees were authorized to add to their number and to choose their successors, provided that the number of trustees should at no time exceed five; (3) the trustees and/or their successors were to hold the trust properties throughout the existence of the trust; (4) the trust was to continue indefinitely for any lawful term; (5) the trustees were authorized to act together, informally over their individual signatures, or collectively, under the name of Porter Property Trustees, Ltd., through duly authorized officers of their board; (6) the trustees, acting as the board of trustees, were authorized to delegate to, by proper resolution, any member or members of the board the necessary authority to transact any and all business of the trust, including the execution of deeds, conveyances, and other instruments in writing; (7) the trustees, in whom "legal and equitable title to all estate properties are vested", were made the absolute owners of the trust properties, with full powers of management thereof; (8) provision was made for regular and special meetings of the board of trustees; (9) the trustees were authorized to engage in any lawful business; to own real estate and personal property in any of the several states, without limit; to buy, sell, improve, exchange, assign, convey and deliver, and to grant trust deeds, and to mortgage or otherwise encumber for obligations; to own stock in or entire charters of corporations; and to engage the trust funds and properties in any industry or investment in their discretion, hoping thereby to make gain for the trust; (10) the trustees were authorized to and did adopt a common seal; (1) the trustees were authorized to regard the trust instrument as their guide, and to supplement the same from time to time by proper resolutions written into the office records of the board of trustees, or to adopt formal bylaws or rules of business conduct; (12) the trustees were authorized to elect a presiding officer, or president, and to select and appoint a board sceretary, and to delegate duties and authority to them; (13) the trustees were authorized to fix and pay all compensation of officers, agents, and employees, and to pay to themselves such reasonable compensation as might be determined by a regular act of their board; (14) the trustees were required to keep a faithful financial record of all business transactions, and the name and address of each known beneficiary; (15) all income and trust funds, when collected or paid over to the trustees, were to constitute a fund from which the trustees should pay trust obligations, reinvest or distribute to the beneficiaries, in their discretion; (16) the personal liability of the trustees was limited to the value of the trust funds and properties; (17) the filing of a copy of the trust instrument in the public records of some designated county was to be constructive notice to the world of such specific personal liability limitations of the trustees, and that all persons, corporations, or companies extending credit to, contracting with, or having claims against the trustees must look only to the funds and properties of the trust for payment or discharge of such obligations; (18) the trustees might provide for annual or other meetings of the trust beneficiaries to hear and discuss reports and forecasts; (19) while they might adopt resolutions of protest or commendation, no act of the beneficiaries, as such, should be mandatory or interfere with the right of the trustees exclusively to manage the business affairs and control the trust funds and properties; (20) the death of a beneficiary should not entitle his legal heirs or representatives to demand any partition of or interest in or distribution from the trust funds or properties, but his legal heirs might succeed to his interest; (21) changes in beneficiaries from any cause should be duly noted by the trustees on their resords; (22) the trustees might at any time, in their discretion, and from any available trust funds, make partial distributions to beneficiaries, and ultimately, upon termination of the trust, should distribute the entire residual trust funds to the beneficiaries in accordance with their proportionate interests; (23) the trust was irrevocable; (24) the beneficiaries might be called by the trustees to meet annually or at other times and they might adopt resolutions but no act of the beneficiaries should be mandatory on the trustees. (R. 27–30.)

James Howard Porter has been, since the trust's inception in 1935, the president of its board of trustees and, with the two other trustees, has managed its business during the same period. He has been more active than the other trustees in its management. He confers informally with the other trustees. Farm lands owned by the trust are leased to farmers for profit. James Howard Porter executes all leases on behalf of the trust and he attempts to negotiate only such leases as will prove profitable to the trust. The affairs of the trust were carried on during the year 1935 in accordance with the terms of the trust instrument. Of the amount of $63,596.29 determined by respondent to have been derived by the trust from "oil royalties" during the year 1935, $46,000 represents a bonus received by the trust from the Standard Oil Co. of California as consideration for the execution of the lease already mentioned. (R. 30–31.)

The James Porter Investment Company sold certain land on installment contracts before February 28, 1935, and on that day transferred the contracts to the petitioner. The fair market value of these contracts at the time of this transfer was equal to the face amount of the balances due thereon. In 1935 petitioner received payments in the aggregate amount of $5,749.50 on account of the contracts. (R. 31.)

The James Porter Investment Company was the owner of an undisclosed number of shares of the Morrison Savings Bank of Morrison, Iowa, before February 28, 1935, and on that day transferred these shares to the petitioner. In 1932 or 1933 a receiver of the bank was appointed and at an undisclosed date the receiver levied an assessment on all the bank's shareholders. Petitioner paid $2,202.50 in 1935 in full satisfaction of its share of the assessment, pursuant to a notice of assessment received by it in the taxable year, which notice was the first notice given of such assessment. (R. 31–32.)

In arriving at the adjusted net income of $13,061.10 for the year 1935, as shown by the notice of deficiency, the Commissioner determined that petitioner had a gross income of $74,794.64, for that year, derived as follows. (R. 32):

Farm income	$1,580.12
Payments Land contracts	8,652.89
Oil royalties	63,596.29
Miscellaneous income	106.19
Interest	859.15
Gross income	74,794.64

In the deficiency notice the Commissioner determined that in 1935 petitioner was an association taxable as a corporation within the meaning of Section 801 (a) (2) of the Revenue Act of 1934 and Articles 801 (2) and (3) of Treasury Regulations 86.

Within the time provided by law the petitioner trust filed an individual income tax return for the year 1935, under Title I of the Revenue Act of 1934, disclosing thereon a net income of $7,192.38 and a tax liability of $337.31. No other return was filed by petitioner for the year 1935.

Upon the basis of the foregoing facts the Board, affirming the Commissioner's determination (R. 10–20), held that the trust owned and operated real estate during the taxable year, and therefore it was an association taxable as a corporation within the meaning of the pertinent statute (R. 37–40). The Board thereupon entered its decision (R. 41) from which the taxpayers petitioned this Court for review (R. 42).

SUMMARY OF ARGUMENT

The trust herein was an association during the taxable year 1935, within the meaning of the statute, regulations and authorities, and is therefore taxable at corporate rates. The evidence shows that it was in fact formed primarily for the purpose of continuing the grantors' properties as going businesses in an organized capacity for profit. It fails to support the taxpayer's contention that the grantors intended, upon creating the trust, that the primary and ultimate purpose of the trust was merely to care for the property and distribute it equitably to the children. According to the terms of the trust instrument, it had unity of management, centralized control, limitation of liability and "expectancy fractions", representing the beneficiaries' shares of interest in the trust property. These are the essential elements of a corporation. The trustees managed and carried on the business activities of the trust for gain, and the profits realized therefrom were distributable or distributed among the beneficiaries on the basis of the proportionate shares of interest each had in the business or property owned, controlled and operated by the trust. The trustees were not restricted to mere incidental and administrative activities such as the collection of funds and payment thereof to the beneficiaries, as in the case of a pure trust. Rather, they had sweeping powers similar to and much greater than those of corporate officers and directors. It follows, therefore, that the trust, created for the same purposes and activities for which a corporation might have been formed for profit, was essentially a statutory association doing business and taxable as a corporation, as determined by the Commissioner and held by the Board.

While the trustees had very broad and complete powers to carry on the business of the trust, it is immaterial whether or not they actually exercised *all* the powers given them by the trust instrument. It is settled that the nature or purpose of the undertaking may not be considered narrower than that formally set forth in the agreement. It was sufficient that they used only whatever powers were actually necessary to manage and carry on the business for the benefit of the trust and those in interest.

The fact that the grantors and not the beneficiaries created the trust is immaterial since it is not necessary that the beneficiaries must have joined in the enterprise at its inception. It is settled that associates may join in such a plan at the outset, or by later participation according to the terms of the agreement share the advantages of a union of their interests in the common enterprise. In either event, the enterprise constitutes an association taxable at corporate rates for income tax purposes.

ARGUMENT

The trust in question was an association taxable at corporate rates during the taxable year 1935 within the meaning of the pertinent statute, regulations and authorities

The Board held that there was a business purpose back of the creation and continuance of the present trust and a single increasing purpose to retain the advantages of centralized control, limitation of liability and the other advantages associated with the corporate form in actively carrying on the trust's business of farming lands and distributing the income therefrom (R. 37, 38); that the bases relied on by the taxpayer as distinguishing the trust from an association are incidental and go merely to the outward form of the trust whereas it is not the particular form of doing business so much as the business purpose and the profit motive which are determinative (R. 38–39); that the facts indicate that the predecessor corporation, through which the family's farming operations were previously carried on, was merely in effect transmuted into the trust which it was thought could be operated without paying corporate rates, but that it was immaterial that certain members of the family passed from the role of active shareholders to passive beneficiaries; and that therefore the trust was an association taxable as a corporation during the year 1935 within the meaning of the statute (R. 40).

We submit the Board was correct in so holding, and that the trust, in its purposes as set forth in the trust instrument and its activities during the taxable year as shown by the evidence, was plainly an association taxable as a corporation under the pertinent statute, regulations and authorities, as shown hereinafter.

The statute provides that the term "person" includes an individual, trust or corporation, and that taxable corporations include "associations". Section 801 (a) (1) and (2) of the Revenue Act of 1934, Appendix, *infra.* The pertinent regulations provide that the term "association" includes any organization, however created, for the transaction of designated affairs or the attainment of some object which, like a corporation, continues and the affairs of which are conducted by a single individual, board or group acting in a representative capacity. Regulations 86, Article 801–2, Appendix, *infra.* They also provide that a trust is an association taxable as a corporation where the trustees, under the trust agreement, hold and manage property with a view to profit for the beneficiaries. Such an arrangement, the regulations state, is designed to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for a corporate organization, thus obtaining the fundamental benefits enjoyed by a corporation. It is not the size or the amount of capital invested in the trust but rather the purposes for which a corporation, under similar circumstances, might have been formed for profit, which are the important and significant distinguishing features between a business and a strict trust. Id., Article 801–3, Appendix, *infra*. We submit that these regulations are reasonable, and not inconsistent with the provisions of the statute as interpreted by judicial authority. Therefore, having the force and effect of law, they should be given effect. *Old Mission Co.* v. *Helvering,* 293 U. S. 289; *Hassett* v. *Welch,* 303 U. S. 303.

The taxpayer contends that the Board's finding that the trust was an association taxable as a corporation, disregards all the evidence that the trust was allegedly established for the purpose of equitably distributing the estate of aging parents among their children and protecting an incompetent son. (Br. 11–16.) It is said that the trust is merely a pure ancestral trust, since no business was carried on other than renting part of the land to tenants. The taxpayer claims that these were merely nominal business activities for the normal care of the trust properties, and the collection and partial distribution of the income therefrom to the beneficiaries (Br. 16–20).

The evidence, however, is to the contrary. The trust instrument (R. 70–90) shows that the primary purposes of the trust were to improve and operate the trust property for profit for the benefit of the grantors' several children as beneficiaries, and to distribute the income to them according to their respective "expectancy fractions" or shares of interest. The trustees were given extensive and complete powers to carry on the operations of the trust accordingly. (R. 27–32, 48, 50–92.) Thus the purposes for which the trust was formed, as set forth in the trust instrument, and its actual business activities and operations carried on by the trustees as shown by the evidence, plainly show that the trust was in fact an operating business trust carried on for profit.

The terms of the trust instrument (R. 70–90) plainly show that the trust was a statutory association having continuity, centralized control, limitation of liability, and all the essential characteristics of a corporation. The trustees, in whom "legal and equitable title to all estate properties are vested" (R. 81–82), had plenary powers of management of the trust properties, and could in their discretion sell any and all of the trust properties at any time as they saw fit (R. 27–28, 74, 76). They had powers of the most sweeping sort to carry on the business of the trust. In fact, their powers were greater than those possessed by the officers and directory of a corporation. For example, they could act together informally over their individual signatures without reference to the board of trustees (R. 28, 75) and, in their discretion, engage the trust funds and properties in any industry or investment in any state in the Union with a view to profit (R. 28, 29, 76).

Moreover, the trustees' powers were exclusive and predominant over any rights of the beneficiaries who had shares of beneficial interests. (R. 25–26, 47, 91–92). The rights of those beneficiaries who were not trustees were limited to the privilege of receiving distributions at the pleasure of the trustees and protesting by resolution, if assembled in meeting by the trustees. In no event could their acts be mandatory or interfere with the rights and powers of the trustees exclusively to manage and control the affairs and properties of the trust. (R. 30, clauses 19, 22, 24; R. 80, Art. 13; R. 82, Art. 17.)

The facts clearly show that the trust was operating and doing business as a statutory association. Thus the Board found (R. 27, 30–32), and the evidence shows (R. 59–70), that during the taxable year one of the trustees acted as president of the board of trustees and, together with the other two trustees, managed and looked after the business interests of the trust; leased the trust's farm lands to tenant farmers for profit; executed all the leases on behalf of the trust; negotiated only such leases as would prove profitable to the trust; and carried on generally the business affairs of the trust during the taxable year in accordance with the terms of the trust instrument.

The trust carried on other business activities as well. A lease negotiated by the predecessor corporation with the Standard Oil Company of California was taken over by the trust upon its creation. Under the terms of the lease, Standard Oil as lessee was obligated to explore, develop and drill certain wells for oil or gas of commercial quality and in commercial quantity. The trust retained oil and gas royalty interests therein, and received in the taxable year 1935 the sum of $46,000 as a bonus from the lessee as consideration for the execution of the lease, in addition to approximately $17,600 derived from other oil royalties during that year. (R. 27, 31.) The trust also received in 1935 the sum of approximately $5,750 from land installment contracts negotiated by the predecessor corporation and transferred to the trust upon its creation in that year (R. 31); and paid approximately $2,200 in 1935 pursuant to an assessment levied by the receiver on shares of stock of the Morrison Savings Bank of Morrison, Iowa, which were transferred to the trust, upon its creation, from the predecessor corporation (R. 31–32).

The evidence amply supports the Board's findings as to the business purposes, activities and operations of the trust for profit. Thus, the testimony shows that the three trustees managed the business interests of the trust and its properties in accordance with the terms of the trust instrument to the best of their ability. (R. 59–60, 65, 69, 70.) They leased the trust's farm properties on a profitable basis to tenants who operated them on a lease basis, took such action as was necessary to enter into such leases for the benefit of the trust, collected whatever rents were due from such lease tenants, and saw to it that all collections of the trust were made and its obligations paid. (R. 48, 61, 62, 68, 69, Br. 18–19.) The trustees kept books of account and financial records reflecting the financial transactions and condition of the trust and all income and disbursements, maintaining a bookkeeper for such purpose. (R. 65, 67, 69–70, Br. 18.) Finally, they made distributions to the beneficiaries from time to time under the terms of the trust. (R. 61, 67, Br. 18–19.) Moreover, it was stipulated that certain of the trust's lands had been improved and farming operations were carried on thereon by the lease tenants (R. 48); and that the trust received income from farm rentals, from landowners' oil royalties under oil and gas leases on the lands at the inception of the trust, and from interest on contracts receivable, likewise acquired (R. 50). Although the evidence indicates (R. 62), and the taxpayer states (Br. 18), that the trustees made some efforts to sell part of the trust's farm lands, they never made any definite offers to sell any part of the property during the time it was under their supervision (R. 68).

Contrary to the taxpayer's contention that the trust was created equitably to distribute the grantor's estate (Br. 11–16), the foregoing demonstrates that the Board's findings are fully supported by substantial evidence. It is settled that findings, thus supported, will not be disturbed on review. *Phillips* v. *Commissioner,* 283 U. S. 589, 600; *Helvering* v. *Rankin,* 295 U. S. 123, 131.

All these facts manifest purposes and activities for which a corporation might have been formed for profit, and that is the test laid down by the regulations. Article 801–3, Regulations 86. The form and mode of operation in which the business was carried on is not controlling. As this Court has held, "the true rule is that purpose and actual operation of the trust should be controlling in determining whether or not the trust shall be classified as an association for tax purposes". *Commissioner* v. *Vandergrift R. & Inv. Co.,* 82 F. (2d) 387, 390. The trustees had complete powers to carry on the business of the trust without the consent of the beneficiaries, much more so indeed than do the directors of a corporation who cannot do certain things without the consent of a majority of the stockholders. It makes no difference whether the trustees actually exercised all the authority given them by the trust instrument. The nature of the undertaking may not be considered narrower than that formally set forth in the agreement. *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369, 374. It was sufficient that the trustees used the powers that were actually necessary to manage and carry on the business. It is immaterial whether or not they used the additional powers given them by the trust instrument.

It is settled that the character of a trust is "determined by the terms of the trust instrument", rather than the particular activities engaged in during the taxable year. *Morrissey* v. *Commissioner,* 296 U. S. 344, 361; *Helvering* v. *Coleman-Gilbert, supra; United States* v. *Trust No. B. I. 35,* 107 F. (2d) 22 (C. C. A. 9th); *Marshall's Heirs* v. *Commissioner,* 111 F. (2d) 935 (C. C. A. 3d). Otherwise, the same organization might be classed as an ordinary trust in one taxable year and as an association taxable as a corporation in another. *Sloan* v. *Commissioner,* 63 F. (2d) 666, 669 (C. C. A. 9th); *Commissioner* v. *Vandergrift R. & Inv. Co., supra.* No such anomalous result is intended by the statute.

Contrary to the taxpayer's contentions (Br. 14–16, 17–18), the trust is not shown by the evidence to have been a pure trust formed merely equitably to distribute the estate to the grantors' children and to hold and preserve the property and collect and distribute the income therefrom to the beneficiaries. The evidence shows that before the creation of the trust in 1935, the beneficiaries, together with their parents, were stockholders of the predecessor family corporation previously organized for the purpose of holding and operating the same family property and farm lands for the benefit of the stockholders. (R. 23–25, 47–49.) The trust was substituted for the corporation and thereafter operated for the benefit of the beneficiaries, some of whom were not competent to manage the property. (R. 37–38, 40, 48–49, 51–56.) In order to avoid corporate taxes, the stockholders dissolved the corporation (R. 37–38, 40) and established the trust (R. 24–25), which merely continued to carry on the business of the preceding corporation (R. 37–38, 40, 47–50). It was not a strict trust, therefore, wherein the trustees merely hold property for the collection of the income and its distribution among the beneficiaries. Rather it was a business trust organized to continue the business affairs of the prior family corporate organization for the benefit of the parties in interest. It continued as a substitute for the former corporation, with the advantages but without the disadvantages of the latter, carrying on the activities and purposes for which another corporation might have been formed under similar circumstances for profit. It was therefore an association taxable as a corporation within the meaning of the statute. Article 801–3, Regulations 86.

The taxpayer apparently considers it material that the trust was created by the grantor rather than the beneficiaries. (Br. 15–16.) In *Morrissey* v. *Commissioner, supra,* the Supreme Court stated at page 357 that in order—

> * * * to provide a medium for the conduct of a business and sharing its gains * * *, a [business] trust may be created as a convenient method by which persons become associated for dealings in real estate, the development of tracts of land, the construction of improvements, and the purchase, management and sale of properties * * * where those who become beneficially interested * * * by joining in the plan at the outset, *or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise.* [Italics supplied.]

Accordingly, even though the beneficiaries herein were not apprised of the formation of the trust or some of them took no part in its organization or operation, as the testimony indicates (R. 51–61, 63–64), that is just as immaterial as if the grantors had formed a corporation to accomplish the same purposes and issued to each of the children his or her shares of the outstanding stock. The non-managing beneficiaries were notified by the principal trustee of their "expectancy fractions", representing their respective shares of interest in the trust (R. 25–26, 91–92), and received or were entitled to their *pro rata* shares of income (R. 61, 67; Br. 18, 19). Therefore, though passive (R. 38, 61, 67), they must be deemed to have been voluntary members of the association just as much as if they had executed the trust themselves. The statute treats such a trust as an association, whether the beneficiaries formed the trust or acquired an interest by purchase or otherwise in an existing trust. Regulations 86, Article 801–3; *Morrissey* v. *Commissioner, supra.*

There have been several cases in which the participating beneficiaries have been given the business in trust instead of creating it themselves. Such organizations have been held to be ordinary business trusts or associations taxable as a corporation irrespective of the fact that they were created by a parent of the beneficiaries, without any voluntary action on their part. *Solomon* v. *Commissioner,* 89 F. (2d) 569, 571 (C. C. A. 5th), certiorari denied, 302 U. S. 692; *Commissioner* v. *Vandergrift R. & Inv. Co.,* 82 F. (2d) 387 (C. C. A. 9th); cf. *Commissioner* v. *Guitar Trust Estate,* 72 F. (2d) 544 (C. C. A. 5th), *contra,* which was disregarded by this Court in the *Vandergrift* case (p. 391) because of the rule laid down in the *Morrissey* case; and was not followed by the Circuit Court of Appeals for the Fifth Circuit in its later decision in the *Solomon* case. Thus, it is apparent there need be no affirmative voluntary action on the part of the beneficiaries at the time of the creation of the trust in order to constitute an association. Merely associating themselves, voluntarily or involuntarily, at any time in a joint enterprise to do business for income or profit is sufficient to constitute a statutory association.

Contrary to the taxpayer's contention that the trust is essentially a liquidating trust (Br. 14–15), the evidence fails to show that the grantors intended to create the trust merely or primarily to preserve, divide and distribute the family estate. If the grantors had merely liquidation in mind upon creating the trust, there would have been no occasion for providing all the powers characteristic of a corporate going concern, notice of the beneficiaries' "expectancy fractions" or shares of interest, centralized control, limitation of liability, continuity of interest, and all the other provisions making it an organization doing business for profit like a corporation. Therefore, "there is no basis therein to conclude that this was purely a liquidating trust". *United States* v. *Rayburn,* 91 F. (2d) 162, 167 (C. C. A. 8th). Moreover, as was stated in that case (p. 168), we can find in the present trust no pure holding company such as in *Lewis & Co.* v. *Commissioner,* 301 U. S. 385, relied upon by the taxpayer (Br. 17). That case is distinguishable in that therein no certificates of beneficial interest were ever issued; the trust was for the benefit of definitely named persons, including the grantor, for the sole purpose of subdividing and selling the land; the rights of the agent as a beneficiary were limited to commissions on property sold; the trustee's duties were purely ministerial with no power to control, direct or participate in the conduct of the selling enterprise contemplated by the contract; and the Supreme Court said that the presence of the trustee and the agent would not, under such circumstances, create an association out of an individual owner of real estate. Neither can we find any purely liquidating trust herein as in *Commissioner* v. *Morriss R. Co. Trust No. 2,* 68 F. (2d) 648 (C. C. A. 7th), and *Commissioner* v. *Atherton,* 50 F. (2d) 740 (C. C. A. 9th).

It has already been shown that the trust was designed for the purpose of, and we submit that its activities actually constituted, "doing of and engaging in business". *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503, 516–517. Moreover, as was held in *Solomon* v. *Commissioner, supra* (p. 571), "The facts found indicate that an extensive and profitable business is conducted which requires constant attention" of the trustee. It is settled that "doing business" is the important test. *Morrissey* v. *Commissioner,* 296 U. S. 344; *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369; *Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Combs,* 296 U. S. 365; *Hecht* v. *Malley,* 265 U. S. 144; *Flint* v. *Stone Tracy Co.,* 220 U. S. 107; *United States* v. *Rayburn,* 91 F. (2d) 162 (C. C. A. 8th); *Solomon* v. *Commissioner,* 89 F. (2d) 569 (C. C. A. 5th), certiorari denied, 302 U. S. 692; *Tyson* v. *Commissioner,* 68 F. (2d) 584 (C. C. A. 7th), certiorari denied, 292 U. S.

657; *Willis* v. *Commissioner,* 58 F. (2d) 121 (C. C. A. 9th); *Trust No. 5833, Security-First Nat. Bank* v. *Welch,* 54 F. (2d) 323 (C. C. A. 9th), certiorari denied, 286 U. S. 544; *Sloan* v. *Commissioner,* 63 F. (2d) 666 (C. C. A. 9th); cf. *Gardiner* v. *United States,* 49 F. (2d) 992 (C. C. A. 1st).

The present case is a much weaker one for the taxpayer than was *United States* v. *Rayburn, supra,* where the trust was organized to hold a tract of land to await future opportunities, carry on the same business as previously, collect the rents and profits and, differently from the instant case, *to sell when a favorable price might be obtainable, and to liquidate.* The court there held it was not merely a holding company or purely a liquidating trust, and that since there were present enough of the elements of a corporation to be classified as an association and the purposes of the trust were identical with those of a corporation, it was taxable as a corporation. The facts there showed that the corporation, after having leased its lands and discovering that there was doubt as to its capacity legally to hold title satisfactorily to oil leases, conveyed its lands to a trust formed by the stockholders. In holding that the trust was engaged in a business enterprise for profit as distinguished from the activity of a purely liquidating trust, the court pointed out that it was created in immediate connection with the leasing of the lands for a long term of years and that obviously the creators of the trust intended to carry on the same business as they had been carrying on under the former company.

The court, reversing the District Court, stated (pp. 166, 167–168):

> The only business carried on by the trustee was the making of these leases; the collection of bonuses and rentals (oil and gas); and distribution of the net proceeds to the beneficiaries. * * *
>
> During the trust, no additional land has been acquired; there has been no development of the land by the trustees. * * *
>
> The trial court found that during these tax years the trustees were not "engaged in carrying on a business enterprise for profit as the main purpose of the organization"; and that "such business as they have done has been incidental to the ultimate liquidation of the property as provided in the trust deed. * * *"
>
> * * * We think no such situation is here present. If we consider the trust instrument alone and apart from all other evidence, there is no basis therein to conclude that this was a purely liquidating trust. That instrument, considered alone, reveals twenty-four tenants in common of a large tract of land conveying it to seven of their number as trustees to be disposed of by the trustees at any time within twenty years after the death of the survivor of such trustees; the trustees given the full powers as of ownership to manage and control the land and all parts thereof until final disposition; provisions for succession as to trustees; provision for unlimited modification of the trust by the trustees and two-thirds in interest of the beneficiaries. The only feature which might suggest a purely liquidation trust or a holding

> trust is that the *corpus* is a definite tract of land and the main purpose is to dispose of that land. In the leading case of *Morrissey* v. *Commissioner,* 296 U. S. 344, 360, 56 S. Ct. 289, 80 L. Ed. 263, and the companion case of *Swanson* v. *Commissioner,* 296 U. S. 362, 365, 56 S. Ct. 283, 80 L. Ed. 273, a single tract of land was involved. It is true that each of those cases dealt with trusts which contemplated improvement of the land before sale. However, it is obvious that the sale of land without prior improvement is as much a business enterprise for profit as any other business undertaking. * * *
> * * * we must conclude that it was taxable as an association within the meaning of Secs. 13 (a) and 701 (a) (2) of the Revenue Act of 1928, 26 U. S. C. A., Secs. 13 (a) and note 1696 (3), for the two years involved here.

We submit that under the facts herein, the case is concluded by the rules laid down by the Supreme Court in *Morrissey* v. *Commissioner, supra; Helvering* v. *Coleman-Gilbert, supra; Swanson* v. *Commissioner, supra;* and *Helvering* v. *Combs, supra.*[1] The controlling force of those decisions was recognized by the Circuit Court of Appeals for the Eighth Circuit in *United States* v. *Rayburn, supra* (pp. 167–168). Those cases arose under the provisions of the Revenue Acts of 1924, 1926, and 1928, relating to the taxability of certain classes of trusts as associations or corporations instead of as strict trusts, and the provisions of those

[1] These cases explain and modify *Crocker* v. *Malley*, 249 U. S. 223. See *Solomon* v. *Commissioner*, 89 F. (2d) 569, 571 (C. C. A. 5th), certiorari denied, 302 U. S. 692.

statutes are substantially the same as those of the Revenue Act of 1934, here involved.

In each of those cases, the trustees had absolute control and management of the trusts, as in this case. The trust property comprised a golf course with an adjoining real estate subdivision in the *Morrissey* case; about twenty apartment houses in the *Coleman-Gilbert* case; a single apartment house in the *Swanson* case; and a single oil lease in the *Combs* case. The trustees' powers were strikingly similar to those of the trustee here. Moreover, the beneficiaries' interests in each of those trusts (except in the *Coleman-Gilbert* case), evidenced by certificates or shares of interest, were personal property and did not terminate the trust at death; and the trustees could not bind the beneficiaries personally, nor were they individually liable except for willful misconduct. In the *Coleman-Gilbert* case, there were no shares of beneficial interest, no meetings, and no corporate records. In the *Swanson* case, where the trust property comprised a single apartment house, *the trustees never held formal meetings,* kept no minute books, had no by-laws, elected no officers, and the operations of the business did not extend beyond the property first acquired. In the *Combs* case, the trust had no office or place of business, no seal, by-laws, or official name, and the trustees' operations were confined to the one lease acquired.

So there is a striking analogy between the determinative elements in those cases and those in the present case—all were actually doing business of one sort or another; continuity, limitation of liability, and centralized control existed; and the essential characteristics of an association are present in each case.

The activities enumerated in the *Morrissey* and related cases do not by any means comprise the sole activities which constitute the carrying on of a business in an organized capacity sufficient to create a taxable association. Those cases show that any activities which amount to more than a mere passive holding of property and a receipt of the income therefrom are sufficient to constitute the carrying on of a business. In the case at bar, the purposes of the formation of the trust as well as the activities carried on, amounted to much more than mere protection, conservation, and distribution of the property. Even where the trustee's sole functions in connection with the oil produced from the trust's oil leases were to collect, care for and dispose of the oil, this Court held such activities constituted doing business for profit so that the trust was taxable as a corporation. *United States* v. *Trust No. B. I. 35, Etc.,* 107 F. (2d) 22 (C. C. A. 9th), reversing 25 F. Supp. 608 (S. D. Cal.), citing, by comparison, *Commissioner* v. *Boeing,* 106 F. (2d) 305, 309 (C. C. A. 9th). It has been held too, that a trust formed merely to operate—leasing to others—a property owned by four heirs was a business trust taxable as a corporation. *Marshall* v. *Commissioner, supra.* Lack of size and complexity do not prevent a trust from being taxable as a corporation. *United States* v. *Trust No. B. I. 35, Etc., supra.* The fact that the trustees conducted the instant trust in some respects substantially in the same manner as many other trusts are conducted, does not in anywise show that this was a strict trust rather than one taxable as an association. Moreover, as to the taxpayer's intimation that it is significant that the trustees held no formal meetings with or without beneficiaries and did not advise them as to the conduct of the affairs of the trust (Br. 18), it is settled that no formal meetings are necessary. *Swanson* v. *Commissioner, supra.* Although the use of corporate forms may furnish persuasive evidence of the existence of an association, nevertheless the absence of particular forms or of the usual terminology of corporations cannot be regarded as decisive. *Morrissey* v. *Commissioner, supra; Commissioner* v. *Vandergrift R. & Inv. Co., supra.* Nor is there any necessity for a strict observance of the usual corporate forms or methods of doing business for they are not conclusive. *Fidelity-Bankers Trust Co.* v. *Helvering,* 113 F. (2d) 14, 17 (App. D. C.); *Helvering* v. *Washburn,* 99 F. (2d) 478, 481 (C. C. A. 8th).

The ultimate question is whether an ancestral trust set up for the purpose of doing business in quasi-corporate form is to be classed as an association. The decisions of the Circuit Courts of Appeals, prior to the *Morrissey* case, appear to be conflicting. Cf. *Willis* v. *Commissioner, supra,* involving a trust created by will, with *Blair* v. *Wilson Syndicate Trust,* 39 F. (2d) 43 (C. C. A. 5th), and *Commissioner* v. *Guitar Trust Estate,* 72 F. (2d) 544 (C. C. A. 5th). See also *Roberts-Solomon Trust Estate* v. *Commissioner,* 34 B. T. A. 723, affirmed *sub nom. Solomon* v. *Commissioner,* 89

F. (2d) 569 (C. C. A. 5th), certiorari denied, 302 U. S. 692, where the Board of Tax Appeals rejected (p. 725) the argument that a trust did not fall within the definition of the *Morrissey* case because the beneficiaries were given the business instead of creating it themselves. We have already shown that the decisions of the Supreme Court in the *Morrissey* and related cases are sufficiently broad to answer the question affirmatively in harmony with our contentions.

In *Commissioner* v. *Vandergrift R. & Inv. Co.*, 82 F. (2d) 387 (C. C. A. 9th), the trust during 1924–1926 owned a substantial interest in a shoe business which was liquidated in 1927. During the period 1927–1930, however, the trust merely received and distributed rentals from a long-term lease and accumulated a reserve fund which was invested in building and loan certificates. The Board of Tax Appeals had there held that the trust was taxable as an association for the earlier but not the later period. This Court, however, held that under the rules laid down by the Supreme Court in the *Morrissey, Swanson, Coleman-Gilbert* and *Combs* cases, *supra,* the trust was taxable as an association for all of the years involved notwithstanding the fact that the trust had completed the liquidation of the shoe business which it had formerly managed.

That case, insofar as it involved the element of liquidation, was a much stronger one for the taxpayer than is the present case, but this Court nevertheless properly held that the trust was taxable as an association.

In *United States* v. *Trust No. B. I. 35, Etc.*, 107 F. (2d) 22 (C. C. A. 9th), this Court, reversing the District Court (25 F. Supp. 698 (S. D. Cal.)), held that the trust there owning oil lands was an association taxable as a corporation on its income for the years 1931–1933, and that the functions of the trustees with reference to the collection, care and disposal of the oil produced from its leases constituted a business for profit even though conducted through an agent.

The taxpayer relies (Br. 14, 19) on *United States* v. *Davidson*, 115 F. (2d) 799 (C. C. A. 6th). That case, however, is distinguishable. There the grantor conveyed his properties in trust for his four children as beneficiaries. Although the trust had some of the characteristics of a corporation, there was no conclusive evidence that it was a business venture. Rather the court found that the trust was formed primarily for liquidation of the settlor's property and therefore it was not taxable as an association under Section 801 (a) (2) of the Revenue Act of 1934. The trust instrument there expressly declared (p. 800) that "the primary purpose of the trust is the conversion of the trust property into money and the distribution of the net proceeds among the persons [the children] holding certificates of shares in proportion to their holdings as hereinafter provided". The trust was to be terminated upon the death of the last of the grantor's children or at any time earlier, in the discretion of the trustee, by liquidation, distribution or transfer to a corporation or a partnership, and the trustee began making large distributions during the taxable years there involved. The District Court found that the trust was not a business venture, but was formed primarily for liquidation of the settlor's property. The court further found that its activities were only incidental to liquidation and distribution of the trust estate, and that large distributions had already been made. The court therefore concluded that the trust was not an association taxable as a corporation. The Circuit Court of Appeals affirmed on the ground that the lower court's findings were supported by substantial evidence. The Board's findings are to the contrary in the instant case, and we submit that they should likewise be accepted as supported by substantial evidence.

In summary, we believe the following conclusions are justified. The primary purpose of the trust here involved was not merely liquidation with incidental activities necessary to preservation of the property, as contended by the taxpayer. Rather, as the great weight of the evidence shows, the trust was created primarily to carry on the family business enterprises intact as going concerns for profit. The trustees had absolute control and management over the property of the trust, more so than officers or directors of a corporation. They were invested with all the powers necessary to borrow money, make loans, make investments from current income of the trust, and every other possible power a corporation could have. Therefore, under the judicial authorities cited, the trust was an association and taxable as a corporation, as determined by the Commissioner and held by the Board.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should therefore be affirmed.

Respectfully submitted.

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APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 801. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

* * * * *

(U. S. C., Title 26, Sec. 1696.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 801–1. *Classification of taxables.*—For the purpose of taxation the Act makes its own classifications and prescribes its own standards of classification. Local law is of no importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See article 801–3.) * * * The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See articles 801–2 and 801–4.) The definitions, terms, and classifications, as set forth in section 801, shall have the same respective meaning and scope in these regulations.

ART. 801–2. *Associations.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. * * *

ART. 801-3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

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